

30. NET INTEREST

Table 30-1. NET INTEREST

(In millions of dollars)

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Function 900	1998 Actual	Estimate					
		1999	2000	2001	2002	2003	2004
Spending:							
Mandatory Outlays:							
Existing law	243,359	227,244	215,187	205,905	194,741	183,237	172,959
Tax Expenditures:							
Existing law	965	1,015	1,065	1,115	1,175	1,235	1,295

The Federal Government pays large amounts of interest to the public, mainly on the debt it incurred to finance past budget deficits.

The Government also pays interest from one budget account to another, mainly because it invests its various trust fund balances in Treasury securities. Net interest—which does not include these internal payments—closely measures Federal interest transactions with the public. In 2000, Federal outlays for net interest will total an estimated \$215.2 billion.

The Interest Burden

As noted above, the amount of net interest depends on the amount of debt held by the public, as well as on the interest rates on the Treasury securities that comprise that debt. Debt held by the public is the total of all deficits that have accumulated in the past—minus the amount offset by budget surpluses. Large deficits in the 1980s and early 1990s sharply increased the ratio of debt held by the public to the Gross Domestic Product (GDP)—from 26.1 percent in 1980 to 50.2 percent in 1993. Partly due to the huge rise in debt, interest rates on Treasury securities also rose sharply. The combination of much more debt and higher interest rates caused a substantial increase in Federal interest costs—from 1.9

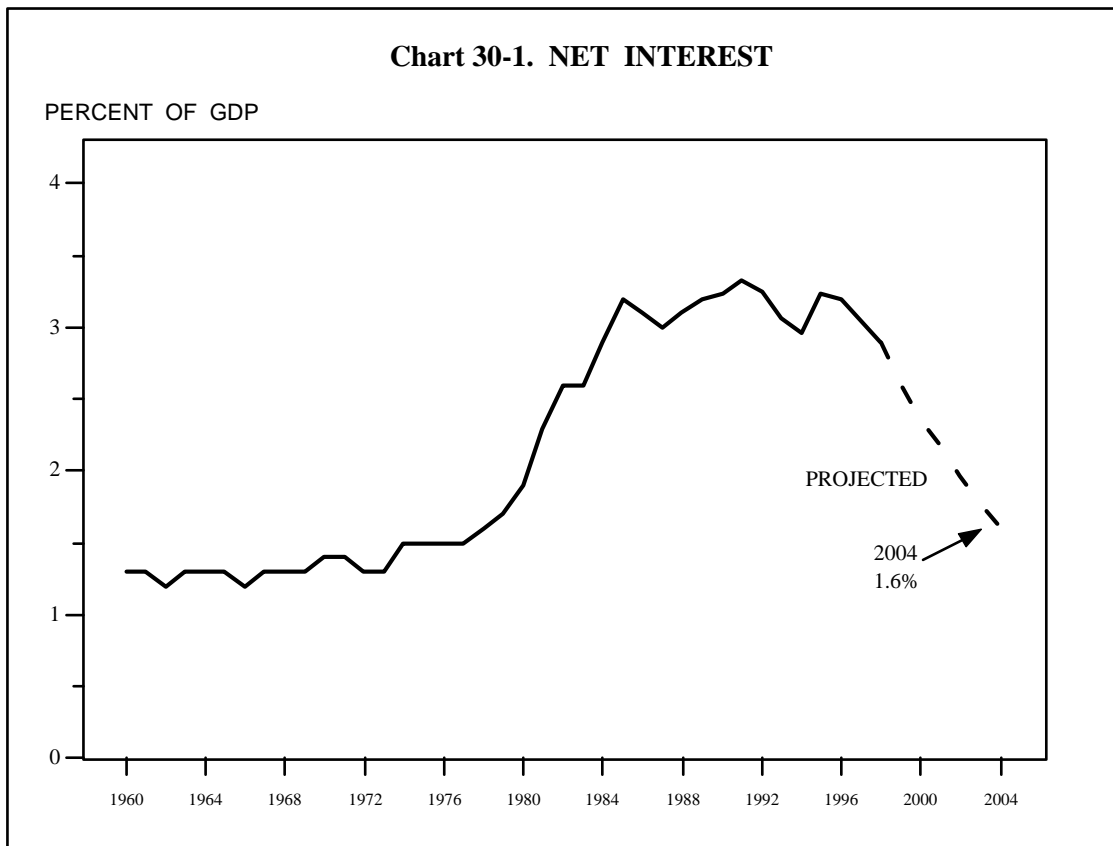
to 3.3 percent of GDP between 1980 and 1991 (see Chart 30-1).

As budget deficits were gradually eliminated, and as interest rates declined, the ratio of net interest to GDP fell from 3.3 percent in 1991 to 2.9 percent in 1998. The combination of budget surpluses starting in 1998, and continued low interest rates, reduce the projected ratio further, to an estimated 1.6 percent in 2004. Thus, the interest burden is projected to fall by one-half in just over a decade. As shown in the table above, net interest in dollars is expected to begin to decline in 1999.

Components of Net Interest

Net interest is defined as gross interest on the public debt minus the interest received by on-budget and off-budget trust funds and minus all activities that fall under "other interest" (discussed later in this chapter).

Gross Interest on the Public Debt: Gross interest on the public debt will total an estimated \$346.5 billion in 2000 and \$339.0 billion in 2004. At the end of 1998, the gross Federal debt totaled \$5.479 trillion, of which \$3.720 trillion was held by the public. The debt held by the public accounted for 23.4 percent of the total credit-market debt owed by the non-financial sector of the U.S. economy. The proportion peaked at 26.8 percent in 1994 and has trended down over the last few years as Federal Government borrowing diminished with



the declining deficits (see Table 12-1 in *Analytical Perspectives*).

Interest Received by Trust Funds: Under current law, the receipts and disbursements of Social Security's old-age and survivors insurance (OASI) trust fund and disability insurance (DI) trust fund are excluded from the budget. Social Security, however, is a Federal program. Thus, the net interest of the Federal Government as a whole includes the off-budget interest earnings. Because Social Security will accumulate large surpluses over the next several years, its interest earnings will rise from an estimated \$56.5 billion in 2000 to \$82.7 billion in 2004.

The other major trust funds are on-budget. The interest earnings of the civil service retirement and disability fund will rise from an estimated \$34.6 billion in 2000 to \$37.4 billion in 2004, and the interest of the military retirement fund will rise from \$12.7 billion to \$13.6 billion. The Medicare Hospital Insurance (HI) trust fund will receive \$9.1 billion in 2000.

Other Interest: Other interest includes both interest payments and interest collections—much of it consisting of intra-governmental payments and collections that arise from Federal revolving funds. These funds borrow from the Treasury to carry out lending or other business-type activities.

Budgetary Effect, including the Federal Reserve

The Federal Reserve System buys and sells Treasury securities in the open market to implement monetary policy. The interest that Treasury pays on the securities owned by the Federal Reserve is included in net interest as a cost, but virtually all of it comes back to the Treasury as "deposits of earnings of the Federal Reserve System." These budget receipts will total an estimated \$25.1 billion in 2000 and \$29.0 billion in 2004.